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SUBJECT: The Japan Economic Scope - May 25, 2007

Sensitive but unclassified. Please protect accordingly.

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¶13. (SBU) Ministry of Agriculture Concerned About U.S. - Japan FTA

The subject of negotiating a free trade agreement with the United States comes up about three times a week, an Agriculture Ministry (MAFF) official told an Economic Section FSN on May 18.

Reflecting the Abe administration's announcement in January to triple free trade agreements to twelve in the next two years, the MAFF official noted that the number of FTA officials within the ministry had increased recently to 60.

The MAFF official asserted that, notwithstanding the goal to boost the number of free trade deals by three-fold, MAFF would

insist that barriers to trade on sensitive items remain in place. Meanwhile, the official conceded that Japanese farmers needed to boost productivity -- this would occur as farmers follow MAFF policies that are encouraging efficiencies, including by consolidating farmland.

Since a proposal by a CEFP subcommittee on EPA and Agriculture reform was released earlier this month, MAFF and Japan Agricultural Cooperatives (JA) have been busy trying to show they are pursuing a reform agenda.

A MAFF advisory committee on farmland reform issued a report May 15 calling for a relaxation of measures to enable more corporate leasing of farmland. JA is expected to announce a set of proposals of its own on the subject in early June.

For background on Japan's FTAs and how they affect agriculture, please see: USDA Foreign Agricultural Service GAIN Report Number: JA7018. (ECON: Ryoko Nakano)

14. (SBU) Australian Ambassador Promotes EPA during Hokkaido Visit

On May 14-16, Australian Ambassador Murray McLean visited Hokkaido on a trip aimed at countering local opposition to the proposed Economic Partnership Agreement (EPA) between Japan and Australia.

Ambassador McLean spoke on the benefits of an EPA to Japan during a public meeting with Governor Harumi Takahashi, a dinner with top officials from Hokkaido agricultural entities, and a well-attended Australian consulate business awards reception in Sapporo. He also criticized Hokkaido government estimates that

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an EPA will negatively affect the Hokkaido economy by \$11.6 billion as "quite exaggerated."

During the awards reception, Australia's Consul in Sapporo told us that Governor Takahashi acknowledged the Australian position but remained steadfast that the EPA would hurt Hokkaido farmers. The consul also described the dinner with agricultural officials as "very tough" since attendees clearly showed no support for an EPA. (Sapporo: Ian Hillman/Yumi Baba)

15. (SBU) Does METI Want to Launch FTA Talks with the United States?

Japan's Trade Ministry (METI) is pushing the envelope and wants to launch FTA negotiations with the United States by 2009, according to a May 22 Kyodo wire service story.

According to the story, which appeared on Kyodo's English language website first, METI wants to launch private sector "studies" on the merits of a U.S. - Japan FTA as early as this fall, and elevate the studies to the inter-governmental level by the fall of 2008, with government-to-government negotiations possibly starting by the summer of 2009.

The Japanese language version of the story, which appeared after the English version, had less definitive language. A METI source we talked to on May 23 emphasized that there has been no change in the ministry's position on negotiating a free trade deal with the United States. (ECON: Nicholas Hill)

16. (U) Asia Scholars Ponder East Asian Economic Integration and Japan and U.S. Role

Japanese scholars uniformly emphasized the need for a U.S.-Japan FTA while China experts were split on the speed of future growth in China at a conference jointly sponsored by the Japan Institute for Social & Economic Affairs (Keizai Koho) and the Brookings Institution in Tokyo on May 21.

Takashi Shiraishi, Vice President of the National Graduate Institute for Policy Studies focused on the need for the United States and Japan to maintain their alliance and further integrate their economies to counterbalance the growth of China. Shiraishi pointed out that the idea of an East Asian Economic Community was still vague and that a U.S.-Japan FTA would anchor the U.S. in the region.

Shujiro Urata, an Economics Professor at Waseda and chair of the CEFP subcommittee on FTAs and agriculture, emphasized that Japan needs an FTA with the United States to give Japan the impetus, (via good, old-fashioned foreign pressure) to improve its efficiency and stay competitive.

A more skeptical Akihiko Tanaka, a University of Tokyo Professor of International Politics, questioned whether the United States even has a regional policy or just has too many policies for East Asia.

Some Chinese experts forecast difficulty for continued fast growth in China if it does not make some major reforms.

Brookings scholar Wing Thye Woo saw potential troubles for the Chinese economy, a view supported by Keio Professor Ryosei Kokubun who predicted that the Chinese economy would lose some steam after the Olympics.

Meanwhile, Chinese scholars working in China such as Shulong Chu of Tsinghua University and Xinghau Ding of the Shanghai Institute of American studies predicted nonstop rapid growth in China.

Ding underscored that there would be no anti-American alliance in East Asia. (ECON: Marilyn Ereshefsky)

17. (SBU) CEFP Begins Work on Basic Policies 2007 for Abe Government

The Prime Minister's Council on Economic and Fiscal Policy will convene on May 25 to begin work on its Basic Policies 2007 document, which is due to be released sometime in June. Coming so soon before July elections, the document will be closely

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scrutinized.

On trade policy, we talked to two members of the CEFP subcommittee which has contributed to a very forward-leaning report recommending that the GOJ push hard to reform its agriculture sector and more aggressively seek Economic Partnership Agreements (see previous two issues of the Scope). Neither of our interlocutors would predict how trade issues would be reflected in the final Basic Policies document. These are very difficult issues and are in the hands of the politicians at this stage, one member told us on May 22.

During a May 18 meeting with Deputy Assistant U.S. Trade Representative Michael Beeman, the Chairman of the subcommittee, Shujiro Urata, told us that obviously there was opposition at the political level, particularly at the Agriculture Ministry. He said he expected the subcommittee's work to continue after elections. (ECON: Nicholas Hill)

18. (U) Regulatory Reform Talks Wrap Up, but Work Remains

Inter-agency U.S. and Japanese delegations met in Tokyo May 14-18 to prepare the draft text of the Report to Leaders, the document that the two governments plan to release to the public at around the time of the next meeting of Prime Minister Abe and President Bush, probably on the margins of the G-8 Summit in Germany June 6-8.

Regulatory Reform is a main pillar in the two countries' bilateral economic relations and includes several working groups covering a wide range of regulatory issues, including: IT and telecommunications; medical devices and pharmaceuticals; financial services and other cross-sectoral issues.

Please contact us if you have any questions about the regulatory reform process. When the Report to Leaders is released, we will put it on the Embassy website. (ECON: Nicholas Hill)

¶9. (SBU) OIE Pronounces U.S. Beef Safe -- Ball in GOJ's Court ---

Long anticipated, the World Organization for Animal Health (OIE) pronounced U.S. beef safe -- or in a "controlled risk" category -- in a decision announced on May 23 at its headquarters in Paris. The decision means that the OIE agrees that there should be no age restrictions on exports of U.S. beef.

"This will not immediately lead Japan to alter its conditions for beef imports," Chief Cabinet Secretary Shiozaki told reporters in Tokyo afterward. He indicated that Japan would look for a determination from its own independent Food Safety Commission (FSC).

Japan's Health and Agriculture Ministries asked us this week for the data that went into the OIE decision, a first step in possibly easing regulations that first banned and subsequently severely limited U.S. beef sales in the Japanese market after a cow was discovered in the United States with BSE in 2003.

Agriculture Minister on May 23 indicated publicly that Japan was "willing" to hold talks with the United States on the subject. The two governments could form a working group as early as June, with the objective on the U.S. side to see Japan adopt OIE, science-based standards that would lead to a full market opening. The GOJ has provided little reason, however, to believe that the process will lead to a full resumption of trade anytime soon. Once the GOJ has studied the data and assessed the BSE risks, a recommendation will be forwarded to the FSC for a decision. (ECON: Nicholas Hill)

¶10. (SBU) PM Abe's Asia Gateway Partially Opens

Accenting aviation policy, late on May 16 the Asia Gateway panel reported out its proposals to implement the PM's Asia Gateway Vision.

PM Abe commented that, "We see strong national interest in the issues related to airline routes and airports, such as the Asia Open Sky and 24-hour operation of international airports....--

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MLIT Minister Fuyushiba, however, felt compelled to remind Abe that "aviation policy responsibilities lie with us."

For Haneda airport, the report called for longer hours for international charters including those to the U.S. and Europe, maximum use of the airport for international flights, and a more flexible perimeter than MLIT was contemplating for when Haneda expansion is completed in 2010.

The report also proposed "Asian Open Skies," for Nagoya and Osaka airports.

The report made some small progress in aviation reforms although U.S. airlines may not benefit directly or in the near term as MLIT was able to blunt any stronger proposals (see Tokyo 2180). MLIT also has tried to exclude any mention of this PM panel's work in the Report to Leaders in the Regulatory Reform talks. (ECON: Josh Handler)

¶11. (U) Regulatory Reform Council Clashes with Transport Ministry Over Aviation Liberalization

The Government's Council for the Promotion of Regulatory Reform (CPRR) and officials from the Ministry of Land, Infrastructure and Transport (MLIT) disagreed on every item regarding aviation liberalization at a May 21 CPRR meeting, according to press

accounts.

Articles state that MLIT officials strongly opposed the panelists' call for liberalizing international airfares and relaxing regulations on foreign ownership of shares in Japanese airlines.

At the meeting, MLIT Director-General for Civil Aviation Bureau, Hisayasu Suzuki, disclosed the possibility of increasing international slots to 40,000 a year at Haneda Airport; an increase of 10,000 slots from the previously allocated 30,000 by the ministry for year 2010 after the airport expansion project is completed.

MLIT Vice-Minister Masafumi Yasutomi, however, subsequently disavowed this increase on May 22, saying at a press briefing that Haneda would have 30,000 slots as planned. Moreover, he believed the aviation issues being considered by the CPRR are already covered by PM Abe's Asia Gateway Strategy Panel, which released its final report on May 16. He said that the respective parties should now concentrate on how to increase international flights to Asia. (ECON: Junko Nagahama)

¶12. (SBU) Japanese Shipbuilding Still Going Strong

Although a high-wage country, Japan's shipbuilders are still going strong, capturing 17.7 percent of new ship orders by tonnage world-wide in 2005, according to a new report by the Japan Ship Exporters' Association.

Japanese shipping companies are expanding their fleets to meet worldwide shipping demand, and the largest container ship built in Japan, a 9,040 TEU (twenty-foot equivalent units) container vessel was recently delivered.

There are some headwinds, however. Japanese shipbuilders face competition from China and Korea and are concerned about their aging workforce. Small and medium shipbuilders are doing less well than the larger yards, but the GOJ is seeking to give them some support and at the same time is seeking to reduce over capacity in the industry. A cable on this topic is to follow shortly. (ECON: Josh Handler)

¶13. (U) Japan: First Quarter Real GDP Grew 2.4%, though Deflation Lingers

Japan's real GDP grew at a 2.4 percent annualized rate in the January to March quarter of 2007, according to the preliminary data announced by the Cabinet Office on May 17.

GDP growth in the first quarter was weaker than private analysts' consensus forecast of a 2.7 percent increase and considerably

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below the revised 5.0 percent rise in the fourth quarter of 2006. Overall real GDP growth for the first quarter reflected a 1.6 percentage-point contribution from net exports and another 1.2 percentage point contribution from final domestic demand, supported by firm personal consumption.

On the other hand, the contribution to overall growth from inventories was -0.4 percentage point and business investment fell in the quarter.

First quarter GDP growth was well above Japan's estimated potential growth rate of about 1.5-2.0 percent.

The overall GDP deflator, while still negative, improved from a 0.5 percent year over year decline in the fourth quarter of 2006 to a 0.2 percent year over year drop in the first quarter, the smallest drop since the second quarter of 1998. (FINATT: Shuya Sakurai)

¶14. (U) Japanese Traditional Industries Fighting for New Markets

Overseas

Small western Japanese manufacturers in traditional industries, such as shoe and towel makers, are trying to recover from a decade-long decline in their domestic shares by developing new overseas markets by supplying high value-added products rather than competing with low price Chinese imports.

According to media reports, several SMEs are doing brisk business overseas, and are seeking to do more. A traditional dyeing business (Yuzen-zome) in Kyoto has opened stores in London and New York, and towel makers from southern Osaka and Ehime have boosted exports of high quality towels to Hong Kong and Taiwan. Shoemakers in Kobe are selling in Europe. In 2006, the towel union sent a mission to the United States for market research, and has embarked upon a strategy of blanketing foreign trade shows with their products.

The export volume of these products has not returned to the peaks of the late 90s, but since 2004 has begun to recover. Nonetheless, the trade data shows that exporters still some way to go. Mr. Manabu Kashii, Managing Director of the Osaka Towel Industry Union, is happy with the growth of exports but pointed out that the export share of total towel sales in the region is still less than 10 percent. Moreover, there is stiff foreign competition as Chinese imports continue to grow, from 50 percent of the domestic market a couple of years ago to 80 percent. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

115. (U) Osaka Businesses Shifting to Tokyo Again?

According to the recent study by Osaka Prefecture, the number of major companies headquartered in Osaka with more than 10 billion yen (\$8.4 million) was 92 in 1994, but dropped to 75 companies a decade later. In addition, pharmaceutical, financial, insurance, and retail companies (i.e., more highly regulated sectors) are moving to the capital at a higher rate than firms in the service industry and manufacturing.

In other cases, Osaka headquarters have been downgraded to branch offices -- a path taken by Osaka trading giant Marubeni in April. Daimaru Holdings, the new holding company for retailers Daimaru and Matsuzakaya, which are merging in September, will put its headquarters in Tokyo, as well.

In addition to the long shadow of Tokyo government agencies, an analyst pointed out that other attractions of Osaka are the concentration of information and better business infrastructure. Therefore, Osaka needs to look closely at its weaknesses and fix them in order to stanch the flow of firms to the east, he said. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

116. (U) Greater Seattle Leadership Delegation Visits Fukuoka & Kitakyushu

On May 12-18, a 70-person strong Greater Seattle International Study Mission visited Fukuoka and Kitakyushu for the second time in three years. Senior executives of Boeing, Microsoft, leading

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U.S. banks, and Seattle law firms were among the delegation's members, as were state and city legislators and academic representatives.

Bill Stafford, President of the Trade Development Alliance of Greater Seattle (TDAGS), noted that the mission's goal was to help local business, civic, and government leaders learn the best practices of other globally competitive cities. The mission focused on what Fukuoka and Kitakyushu are doing with regard to high-technology strategies, environmental policies, and the challenges of an aging society. Consulate Fukuoka Principal Officer Joyce Wong gave the delegation a presentation on "What (Seattle) can learn from Fukuoka."

To promote investment, trade and business exchanges between Fukuoka and Seattle, leaders from the two cities and the Fukuoka Chamber of Commerce and Industry and TDAGS signed a Memorandum of Agreement on May 14. (Fukuoka: James Crow)

¶17. (SBU) Asbestos Inspection: U.S. EPA Method Is Far More Accurate, Speedy and Economical Than GOJ Regulation

At a seminar on asbestos inspection of building materials on May 23, experts stressed that the U.S. EPA method is far more accurate, speedy and economical than the GOJ-instructed Japanese Industrial Standards (JIS) procedure.

To see if a building contains asbestos, the EPA Method 600/R-93/116 requires checking five traits and takes only one to two hours to obtain the result, whereas Japan's JIS method relies on one optical trait only and yet can take as long as one week. The Ministry of Health, Labor and Welfare (MHLW), however, has published a directive to use the JIS method. Industry observers say that JIS even plans to revise the method in October 2007 to eliminate any possibility to use another method, so the organization can protect current vested interests.

Dr. Hironori Kamemoto, Director for Earth Appraisal Co. Ltd., which held the seminar, recounted that JIS committee members created its method without expertise on the EPA technique which is now the international standard adopted by Europe and Taiwan. Local governments responsible for asbestos inspection are troubled by the bizarre situation -- an official from Chiyoda-ku in Tokyo stated at the seminar that it is very difficult to conduct inspections under the current Japanese system. (EST: Keiko Kandachi/ Joyce Rabens)

¶18. (U) CO2 Emission Trading Scheme in Osaka

The Kansai Economic Federation (Kankeiren)'s study group on Asia's first CO2 emission trade market has begun recruiting SMEs to join the scheme in Osaka. Due to their smaller scale, these firms would operate in clusters. The clusters would pool emission savings and serve as traders in the market. One remaining problem: while financial institutions, sensing opportunities for profit generation, are eager to participate, manufacturers have been reluctant to invest in the scheme. (Osaka-Kobe: Phil Cummings / Naomi Shibui)

¶19. (U) Daisuke Matsuzaka Wins Player of the Week Honors in American League for the Red Sox

We just thought our readers would like to know that. (ECON: Nicholas Hill)

¶20. (U) Pickering Fellow Virsa Hurt

The Tokyo Economics Section would like to welcome Pickering Fellow Virsa Hurt. A graduate student in International Economic Policy at Columbia University, Ms. Hurt will be with us for the next ten weeks. Her projects include looking at how income disparities (kakusa) are likely to affect the July Upper House elections and taking over the editing of this fine newsletter. Hurt speaks Japanese, having done her junior year abroad at Waseda University, and has State Department experience, having worked in the Office of Transportation Policy and in Embassy

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Accra. If you wish to send Ms. Hurt any words of wisdom or kernels of advice, she can be reached at hurtvy@state.gov. (ECON: Sally Behrhorst)

SCHIEFFER